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DEPT PASS DOC/ITA/MAC/WH/OLAC ANNE DRISCOLL
DEPT PASS TREASURY IA LUYEN TRAN

SENSITIVE
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SUBJECT: BRAZIL: INFRASTRUCTURE AND MORE - TREAS DAS O'NEILL VISIT

REF: A) Brasilia 36 B) Brasilia 196

¶1. (SBU) SUMMARY: In January 29 meetings with BNDES, Casa Civil, Central Bank, and Planning and Finance Ministries, Treasury Western Hemisphere DAS Brian O'Neill advanced discussion of a possible US-Brazil infrastructure initiative, further explored bilateral investment and tax treaties (see para 11), and discussed other issues ranging from the OECD to the IMF. DAS O'Neill welcomed the establishment of the BNDES infrastructure Project Facility Fund. Casa Civil indicated MRE may propose a specific infrastructure project for joint cooperation by early March. DAS O'Neill noted USG would react soon to projects proposed by the Planning Ministry. END SUMMARY

Casa Civil excited about the PAC

¶2. (SBU) In a meeting with U/S Miriam Belchior, the ExecSec for the PAC, and staff, Casa Civil indicated that MRE intends to propose an infrastructure project for joint US-Brazil cooperation (a Atlantic-Pacific railway) before the Secretary's visit. The Ambassador cautioned that any such proposal would need to be presented well in advance to ensure Washington would have time to consider the idea, including environmental, political and economic factors, before USG could welcome any proposal. The Ambassador also suggested that a Brazilian proposed list of a number of possible projects, drawing possibly from the energy and transportation baskets of the PAC (ref B), for USG interagency review, might be the most helpful way forward.

¶3. (SBU) Planalto officials provided an overview of proposed and initiated projects in the three PAC categories (transport, energy and social/urban) and noted status updates will be published every four months through 2010 (see ref B). Belchior noted that BNDES (or sometimes World Bank or IDB) usually carries out the feasibility studies. Belchior said the studies determine whether government funding/participation is necessary in a given project. All Casa Civil participants looked noticeably uncomfortable when DAS O'Neill suggested that market forces, eg auctions, would demonstrate whether public, private or a mix was the most appropriate for a given project. Belchior indicated that the political costs of an "failed" (ie, insufficient private sector interest) auction would be considered too high by the government, hence the preference for studies to pre-determine the project mix. Chief of Staff Antonio Alves noted that contract security and judicial issues were problems often highlighted by the private sector. He indicated that the private sector has expressed frustration that in contracts involving some public sector money, contract terms are often changed after the fact to require private sector participants to contribute more than expected to "rebalance" the project mix.

¶4. (SBU) Casa Civil explained that PAC is managed by an executive

committee comprised of Casa Civil (exec sec), Planning and Finance Ministries. Working groups for specific sectors (eg, oil/gas, rail, road, ports, airports, metro, housing, sanitation) meet weekly in half-day sessions to review specific project progress. Participants explained that BNDES is generally involved in a support role, via a contract to provide operational support in consultation with the relevant sectoral Ministry (Transport, Mines and Energy, etc) and the PAC Ministries (Planning, Finance, Casa Civil). BNDES may, in turn, contract out the operational support/studies it is asked to provide. New projects advance through the working group process to Ministers (Casa Civil, Planning, Finance) for approval.

¶5. (SBU) Ambassador Carlos Texeira, Casa Civil special advisor for international issues, indicated that GOB would like to arrange a "roadshow" to the United States to showcase PAC projects and stimulate US investor interest. He asked that USG engage to make this proposal a success. DAS O'Neill agreed to help and noted his view that an infrastructure mission to Brazil would complement this idea. Casa Civil concluded the meeting by emphasizing that the PAC is predicated on Brazil's economy continuing to grow and is intended to strengthen that growth by creating additional jobs and opportunities. However, Antonio Alves cautioned, any global slowdown that affects Brazil would impact PAC's potential for success.

Central Bank -new International Affairs Director

¶6. (U) In a brief courtesy call with Maria Celina Berardinelli, the new Central Bank Director for International Affairs, DAS O'Neill and Berardinelli provided each other a quick overview of their respective economies. Berardinelli stated short-term volatility would be high, but CB is "calm" regarding the medium-term, in part due to Brazil's flexible exchange rate, in part due to high reserves, and in part because Brazil is an external creditor with low debt to the United States. Berardinelli, noting she had been in

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place only one week, indicated her expected priorities for 2008 to include: 1) following up on her predecessor's work to liberalize exchange regulations and ease restrictions on international exchange markets' use of the real; 2) G-20 chair responsibilities for Central Bank; and 3) working with Argentina to design the details of the plan to permit transactions for goods in local currencies rather than the dollar. She evinced enthusiasm for this initiative, noting this Mercosul pilot would open up export opportunities for small firms that do not have the ability to run the hoops required to transact in dollars.

BNDES - Project Fund Facility for infrastructure projects

¶7. (U) Luciano Coutinho, President of BNDES, emphasized that BNDES' role, by law, is to provide operational support to GOB on infrastructure projects, but that only Casa Civil/Planning Ministry/Finance Ministry (with sectoral Ministry input) can actually greenlight specific projects. He described a fifty million usd Project Facility Fund established at BNDES in December. This revolving fund will be used by BNDES to contract out project development modeling. Based on a project study's results, BNDES will recommend to the government whether a project can be done entirely privately OR requires public funding OR could be down as a public-private partnership. Once a bidder is selected for a given project, that bidder has to pay the fund back for the cost of the study. Coutinho noted that Brazilian law had to be changed to permit establishment of such a fund. Coutinho welcomed a similar fund that Citi and Bradesco are developing, noting a private fund will be able to react more quickly and flexibly as BNDES is bound by the rules of public procurement law. Coutinho emphasized that BNDES welcomes any additional support for project development, including further work with USTDA.

¶8. (U) BNDES is working with IDB to winnow down IDB's lengthy list of Latin American regional integration logistics and energy project proposals and identify priority projects for Brazil. BNDES plans to work cooperatively with IDB, WB, and/or CAF on selected projects, drawing on an IFC/IDB/BNDES fund that has a small budget.

¶9. (U) A follow-on meeting with BNDES number two for infrastructure projects Rodolfo Torres and Planning Ministry Chief economist Luis Pereira discussed similar themes. Treasury DAS O'Neill indicated

the Washington interagency is considering Planning Ministry's proposed list of potential projects for US-Brazil cooperation and will provide a reaction in mid-February. DAS O'Neill agreed with the Ambassador that a permanent USTDA representative in Brazil would be helpful as the initiative moves forward.

FinMin COS Melin on Investment, Tax Treaty, OECD, IMF, Debt

¶10. (SBU) Regarding investment agreements, Luis Melin, Finance Minister Mantega's new chief of staff (formally the International Affairs Head), Melin noted executive agencies' extreme caution in negotiating a first or model agreement based on the CAMEX-discussed principles. He noted that discussions regarding negotiating strategy and the principles themselves are on-going. Finance's priority is to negotiate with Argentina, where Brazilian investors are clamoring for protection. Finance continues to argue for the principles to include an explicit reference to an investor-state dispute resolution mechanism (which he confirmed is not currently included). On a bilateral tax treaty, he acknowledged the concerns regarding revenue loss, but underlined that a tax treaty "with the US is far more complex for us than with other countries" noting in particular the "challenging factors" of differences in accounting systems, legal systems, and federal/state relationships in both countries. Melin suggested the best approach would be "to tackle tax treaty issues one by one" to see what is achievable in discrete areas to increase mutual understanding and ascertain mutual gain. He suggested that both sides discuss accounting issues, legal issues, revenue loss studies, etc incrementally, "without saying we need a tax treaty by date X."

¶11. (SBU) Treasury noted the TFCA confirmation may be ready by the end of February. Melin welcomed this agreement as significant economically and important politically for Brazil at a time it is managing much criticism regarding its environmental stewardship. Melin was pleased he had succeeded in reversing Brazil's position regarding voice and vote in the IMF and indicated progress that Treasury would welcome would now be possible. On OECD, Finance is interested in finding areas of possible cooperation, mindful of MRE caution (Finance invited OECD as an observer to the G-20 they chair this year). On debt relief, Melin noted Brazil's evolving approach, and continuing controversial discussions with Congress and with MRE regarding how far Brazil should go. He noted Brazil's actions on Liberia and Guinea-Bissau, where GOB was able to offer more than originally planned after much internal negotiation. He cautioned that Iraq debt relief could be "the straw that broke the camel's back" in encouraging a more forthcoming Brazilian approach to debt

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relief, underlining the enormous political controversy Iraq generates in the Brazilian Congress and government.

¶12. (SBU) COMMENT - DAS O'Neill's meetings greatly advanced mutual understanding regarding Brazil's process and mechanisms for choosing and designing infrastructure projects as well as US mechanisms such as USTDA that may be helpful. In addition, Finance Ministry feedback regarding challenges regarding the bilateral investment treaty and bilateral tax treaty was useful as USG considers next steps. In a very positive day of meetings, where the mutual desire for cooperation was evident, the issue of requested Brazilian debt relief for Iraq was a noticeable difficult moment. END COMMENT

Treasury has cleared this message.
SOBEL